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No. 89-56 No. 89-79 No. 89-101

Supreme Court, U.S.
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In The
Supreme Court of the United States
October Term, 1989

NANCY ALLEVATO, as Personal Representative of the ESTATE OF MICHAEL J. FERRANTINO, SR., *ET AL.* (Petitioners in No. 89-56), THE CITY OF DETROIT (Petitioner in No. 89-79), AND COLEMAN A. YOUNG (Petitioner in No. 89-101),

Petitioners,

v.

THE COUNTY OF OAKLAND and THE COUNTY OF MACOMB,

Respondents.

THE COUNTY OF MACOMB'S BRIEF OPPOSING THE PETITIONS OF NANCY ALLEVATO, AS PERSONAL REPRESENTATIVE OF THE ESTATE OF MICHAEL J. FERRANTINO, SR., *ET AL.*, THE CITY OF DETROIT, AND COLEMAN A. YOUNG FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTIONS PRESENTED

I.

Whether, because of the sparse substantive record in this case and its interlocutory posture, the issues presented merit present review by this Court?

II.

Whether the Respondent Counties which were the overcharged direct purchasers of sewerage services have standing to sue under §4 of the Clayton Act for price fixing violative of §1 of the Sherman Act, for violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), and for breach of fiduciary duty arising under state law?

III.

Whether the Court of Appeals for the Sixth Circuit properly rejected the "passing on" defense asserted by Petitioners when, under state law, any recovery obtained by the Respondent Counties would likewise be "passed on" to those municipalities and end-users?

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Respondent, the County of Macomb, Michigan ("Macomb"), respectfully prays that this Court deny the petitions of Nancy Allevato, as Personal Representative of the Estate of Michael J. Ferrantino, Sr., *et al.*, the City of Detroit, and Coleman A. Young, for a writ of certiorari. The United States Court of Appeals for the Sixth Circuit reversed the district court's dismissal of Macomb's complaint and remanded the case for further proceedings. There is no conflict between the Sixth and Seventh Circuit Courts of Appeal on the unique and specific issues presented and the Sixth Circuit's decision is in accord with settled jurisprudential principles. Moreover, the issues presented should not be reviewed by this Court at this time, in any event, because of the sparse substantive record and the present interlocutory posture of this case.

STATEMENT OF THE CASE

The Counties of Oakland ("Oakland") and Macomb ("Macomb"), Michigan, (the "Counties" or "Respondents") commenced this antitrust and RICO treble damages action in 1984.[1] The action followed criminal convictions of several of the Petitioners, in *United States* v *Bowers*, 828 F.2d 1169 (1985). The Counties alleged that Petitioners participated in a scheme and pattern of illegal price-fixing and monopolizing regarding certain contracts for the disposal of sludge treated by the Detroit Water and Sewerage Department (the "DWSD"). Pursuant to state statute, Mich. Comp. Laws §46.173, the Counties had entered into contracts with the City of Detroit and the DWSD for sewerage services (the "Contracts"), and payments to Detroit under the Contracts included the alleged illegal overcharges for the disposal services.[2] Pursuant to those Contracts the Counties are the direct purchasers of the DWSD's sewerage services on behalf of themselves and the municipalities and residents within their political boundaries. Under those state statutes, the Counties do not derive a profit under the Contracts. Rather, they are to collect their costs, including payment to Detroit under the Contracts,

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[1] The Counties' action is pursuant to §4 of the Clayton Act, 15 U.S.C. §15, and the similar provision in RICO, 18 U.S.C. §1964(c). This case also involves a state law claim for breach of fiduciary duty against Petitioner Coleman A. Young.

[2] Public Act 342 of 1939 authorized counties to establish and provide county sewage services. A county exercising such authority must designate a "county agency" to discharge that authority and to be responsible for the supervision and control of the management of such services. Mich. Comp. Laws §46.173. The counties are authorized to build and maintain all necessary facilities; determine rates, charges and assessments to be collected for such services; and to enter into and enforce contracts in connection with such services, including contracts with users for the provision of such services. Mich. Comp. Laws §§46.171 *et seq.*

from the municipalities, which, in turn, allocate the costs to their residents. Mich. Comp. Laws §46.175.[3]

Macomb joined this action to recover damages for the illegally increased costs of sewerage services. Under state law, any recovery will inure to the benefit of the municipalities, and, ultimately, the residents of Macomb. The county agency that is responsible for managing the county sewage system must establish "just, equitable, and uniform rates, charges or assessments" and "the amounts fixed for rates, charges, or assessments" must only include the "complete and actual cost" of the sewage system. Mich. Comp. Laws §46.174.

Prior to filing answers, and prior to the conduct of any discovery, Petitioners moved to dismiss the complaints on numerous independent dispositive bases pursuant to Fed. R. Civ. P. 12(b)(6). The district court dismissed the complaints on the ground that the Counties lacked standing to sue.[4] 620 F. Supp. 1399. The Counties filed a motion to alter judgment, attaching an affidavit of the Oakland Chief Deputy

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[3] Each local governmental unit within a county system pays the county for sewage services out of funds it collects from users of the services. The funds collected by the counties are maintained by the counties in separate enterprise funds and may be used only for the purposes authorized by statute.

[4] Petitioners asserted numerous other grounds for dismissal. For example, the City of Detroit argued that the Counties' action was barred by the Local Government Antitrust Act of 1984, 15 U.S.C. §§34 *et seq.*; that the Counties had failed to plead a RICO claim because the entities and persons described in the complaint were not "separate"; and that the Counties had not sustained any damages. Petitioner Young, joined by Petitioner Allevato, asserted that the activities complained of were exempt state action; that the Counties' action was barred by judicial and executive governmental immunity; that the Counties' complaints failed to state an antitrust claim because no antitrust injury, in addition to injury in fact, had been pled and no injury to competition had been pled; and that the Noerr-Pennington doctrine provides an exception to the antitrust activity alleged in the complaints as a matter of law.

Drain Commissioner which clarified the contractual and political relationships between the DWSD, the Counties, the municipalities and their residents, the end users of the sewerage system. The court denied the motion, 628 F. Supp. 610, and the Counties appealed from the court's orders granting the motion to dismiss and denying the motion to alter that order.

On January 27, 1989, the Court of Appeals for the Sixth Circuit reversed the decision of the district court and reinstated the complaints. 866 F.2d 839. Nancy Allevato, as Personal Representative of the Estate of Michael J. Ferrantino, Sr., *et al.*, the City of Detroit, and Coleman A. Young then filed the instant Petitions for a Writ of Certiorari (the petitions of "Allevato", "Detroit", and "Young", respectively).

REASONS FOR DENYING THE PETITION

There has been no answer, discovery or trial in this case. The record includes only the Counties' complaints, an affidavit of Oakland's deputy drain commissioner, the Petitioners' motions to dismiss the complaints and supporting briefs and the Counties' briefs opposing dismissal. As noted above, other grounds for dismissal were asserted by Petitioners, which the district court has never addressed. In its present interlocutory posture the issues in this case do not warrant this Court's review at this time.

The Sixth Circuit's decision correctly applied this Court's decision in *Hanover Shoe, Inc.* v *United Shoe Machinery Corp.*, 392 U.S. 481 (1968). Contrary to the arguments in the petitions of Allevato and Young, the Sixth Circuit's decision does not conflict with the *en banc* decision of the Seventh Circuit in *State of Illinois ex rel. Harrington* v *Panhandle Eastern Pipe Line Co.*, 852 F.2d 891 (7th Cir.) (*en banc*), *cert. denied*, ____ U.S. ____, 109 S.Ct. 543 (1988), nor is it inconsistent with this Court's decision in *Illinois Brick Co.*, v *State of Illinois*, 431 U.S. 720 (1977), or any of the decisions in other circuits applying *Illinois Brick*. The factual circumstances of this case,

including its public sector aspects, make this case unique and render application of the sound jurisprudential principles of *Hanover Shoe* and *Illinois Brick* relatively simple. Because this case presents the "perfect pass on" regarding both the illegal overcharges and the allocation of any recovery of damages for the overcharges, none of the complex economic and jurisprudential policy considerations presented in those cases are even implicated. In short, the difficult issue decided in *Hanover Shoe* — whether to allow a direct purchaser to recover a windfall rather than allowing antitrust violaters to escape liability — is simply not involved. Nor is there any risk that Petitioners will be exposed to multiple liability. The Sixth Circuit's decision serves all of the policies addressed in *Hanover Shoe* and in *Illinois Brick*.

THE SIXTH CIRCUIT CORRECTLY HELD THAT THE CIRCUMSTANCES OF THIS CASE DO NOT WARRANT CREATING AN EXCEPTION TO THE RULE IN *HANOVER SHOE*.

In *Hanover Shoe*, *supra*, this Court rejected as a matter of law the defensive use of the pass-on theory by an antitrust defendant against a direct purchaser who had sued for treble damages under §4 of the Clayton Act. The Court held that a direct purchaser is injured within the meaning of §4 by the full amount of the overcharge paid by it and that an antitrust defendant is not permitted to introduce evidence that the plaintiff had passed on the illegal overcharge to others farther along in the chain of distribution. 392 U.S. at 494. The Court followed long standing precedent that the "victim of an overcharge is damaged within the meaning of §4 to the extent of that overcharge." 392 U.S. at 491 (citing *Southern Pacific Co.* v *Darnell-Taenyer Lumber Co.*, 245 U.S. 531 (1918)).

The *Hanover Shoe* Court rejected the pass on defense notwithstanding "the argument that sound laws of economics require" that it be recognized. 392 U.S. at 492. The Court reasoned that accepting the defense would complicate treble-damage actions because of the economic uncertainties and complexities of quantifying the effects of the overcharge on the purchaser's prices, sales, costs, and profits. 392 U.S. at 492–493. Another equally important reason for the Court's rejection of the defense was its unwillingness to risk the chance that antitrust violators would "retain the fruits of their illegality" because indirect purchasers might "have only a tiny stake in the lawsuit" and much less incentive to sue than a direct purchaser. 392 U.S. at 494. The Court concluded that rejecting the pass-on defense was consistent with the Congressional intent of promoting the effective enforcement of the antitrust laws. 392 U.S. at 492–494. The Court reasoned:

> "[I]f buyers are subjected to the passing-on defense, those who buy from them would also have to meet the challenge that they passed on the higher price to *their* customers. These ultimate consumers, in today's case the buyers of single pairs of shoes, would have only a tiny stake in a lawsuit and little interest in attempting a class action. In consequence, those who violate the antitrust laws by price fixing or monopolizing would retain the fruits of their illegality because no one was available who would bring suit against them. Treble-damage actions, the importance of which the Court has many times emphasized, would be substantially reduced in effectiveness." 392 U.S. at 494.

The prospect of allowing the defensive use of the pass-on theory, either as a complete bar to a direct purchaser's action or as a limitation on the measure of damages, involved, among other things, the following competing policy considerations: (a) whether to allow an antitrust plaintiff who had "passed-on" all or some of an illegal overcharge to obtain a windfall —the entire amount of the overcharge or (b) whether to allow a

decrease in the effective enforcement of the antitrust laws by allowing violators to retain a portion of the illegal overcharges. As explained in *Illinois Brick Co.* v *Illinois*, *supra*, 431 U.S. at 752 (Brennan, J., dissenting):

> "*Hanover Shoe* thus confronted the Court with the choice, as had been true in *Darnell-Taenzer*, of interpreting §4 in a way that might overcompensate the plaintiff, who had certainly suffered some injury, or of defining it in a way that under-deters the violator by allowing him to retain a portion of his ill-gotten overcharges. The Court chose to interpret §4 so as to allow the plaintiff to recover for the entire overcharge. This choice was consistent with recognition of the importance of the treble damages action in deterring antitrust violations." *Id.*

Illinois Brick presented the related issue whether indirect purchasers could offensively assert the pass-on theory to recover damages pursuant to §4 for the portion of illegal overcharges passed on to them. This Court, by a six-to-three vote, held that only overcharged direct purchasers were "injured" within the meaning of §4. The Court declined to allow the offensive use of the pass-on theory for two reasons: to avoid the "serious risk of multiple liability for defendants," 431 U.S. at 732, and to avoid the "costs to the judicial system and the efficient enforcement of the antitrust laws" that would result from the complexities and uncertainties of analyzing "price and out-put decisions 'in the real economic world rather than an economist's hypothetical world.'" 431 U.S. at 732 (quoting *Hanover Shoe*, *supra*, 392 U.S. at 493).

The Illinois Brick Court confronted the choice of allowing the risk of multiple liability or denying recovery to indirect purchasers who had absorbed illegal overcharges "passed on" from innocent direct purchasers. The majority resolved, consistent with *Hanover Shoe*, to allow direct purchasers to

recover the full amount of the overcharge and to deny recovery to indirect purchasers. The majority reasoned:

> "We think the longstanding policy of encouraging vigorous private enforcement of the antitrust laws, see, *e.g.*, *Perma Life Mufflers, Inc.* v. *International Parts Corp.*, 392 U.S. 134, 139, 88 S.Ct. 1981, 1984, 20 L.Ed.2d 982 (1968), supports our adherence to the *Hanover Shoe* rule, under which direct purchasers are not only spared the burden of litigating the intricacies of pass-on but also are permitted to recover the full amount of the overcharge. We recognize that direct purchasers sometimes may refrain from bringing a treble-damages suit for fear of disrupting relations with their suppliers. But on balance, and until there are clear directions from Congress to the contrary, we conclude that the legislative purpose in creating a group of '"private attorneys general"' to enforce the antitrust laws under §4, *Hawaii* v. *Standard Oil Co. of Cal.*, 405 U.S., at 262, 92 S.Ct., at 891, is better served by holding direct purchasers to be injured to the full extent of the overcharge paid by them than by attempting to apportion the overcharge among all that may have absorbed a part of it.
>
> "It is true that, in elevating direct purchasers to a preferred position as private attorneys general, the *Hanover Shoe* rule denies recovery to those indirect purchasers who may have been actually injured by antitrust violations. Of course, as Mr. Justice BRENNAN points out in dissent, 'from the deterrence standpoint, it is irrelevant to whom damages are paid, so long as some one redresses the violation.' *Post*, at 2082. But §4 has another purpose in addition to deterring violators * * *; it is also designed to compensate victims of antitrust violations for their injuries. * * * In view of the considerations supporting the *Hanover Shoe* rule, we are unwilling to carry the compensation principle to its logical extreme by attempting to allocate damages among all 'those within the defendant's chain of distribution,' *post*, at 2082, especially

> because we question the extent to which such an attempt would make individual victims whole for actual injuries suffered rather than simply depleting the overall recovery in litigation over pass-on issues." 431 U.S. at 746. (Footnotes and citations omitted.)

In *dicta*, the Court mentioned two possible narrow exceptions to the rule in *Hanover Shoe*, as recently noted by this Court in *California* v *ARC America Corp.*, 490 U.S. ____, 109 S.Ct. 1661, 1663, n2 (1989):

> "When the direct purchaser and the indirect purchaser have entered into pre-existing cost-plus contracts, *Illinois Brick Co.* v. *Illinois*, 431 U.S., at 732, n. 12, 97 S.Ct., at 2067, n. 12, and when the direct purchaser is owned or controlled by the indirect purchaser, *id.*, at 736, n. 16, 99 S.Ct., at 2070, n. 16."

Those possible narrow exceptions must be viewed in the light of the competing policy considerations underlying the rule in *Hanover Shoe*. The policies discussed in *Illinois Brick* and *Hanover Shoe* are these: *First*, that violators should not escape liability under the antitrust laws and those laws should be efficiently enforced; *Second*, that the antitrust laws should be construed to further the policies of deterrence and compensation; *Third*, that violators should not be exposed to multiple liability; and *Fourth*, that direct purchasers who have suffered no true injury should not be unjustly enriched by a windfall judgment. The Sixth Circuit's decision in this case serves all of those policies.

Petitioners acknowledge that Oakland and Macomb Counties are not like middleman merchants. That is, the Counties' Contracts with Detroit have been made pursuant to Michigan statutes which authorize the Counties to provide sewage services to their inhabitants and require that they do so at cost. As the petition of Allevato says: "[t]his case presents a perfect pass on * * *." Allevato petition at 13.

By law, the Counties' sewage operations must be nonprofit; the counties must charge sufficient amounts to their

constituent communities to recover the costs the Counties incur and they may not charge more. This means that, if the Counties recover, they will not garner a windfall, for they must pass on the recovery, as they passed on overcharges.[5] As Allevato's petition states, the Counties "could not retain the fruits of victory." Allevato Petition at 17. The Sixth Circuit made note of that legal obligation:

> "As we understand it, however, the funds are non-profit, so any recovery would ultimately have to be passed through to the end-users via charges lower than those that would otherwise be imposed." 886 F.2d at 850, n. 6.

The Counties operate sewage funds under state laws which make it clear that the Counties are not merchants engaging in trade. Rather, they are fulfilling a public health function with state-granted power to make and enforce contracts. This distinguishes the Counties from cost-plus middlemen, who operate for the purpose of making profits and avoiding losses. When an innocent middleman purchases from an antitrust violator, he is entitled to claim damages. However, if that middleman has passed his "injury" along to end purchasers, pursuant to cost-plus contracts, a fundamental problem in the administration of justice arises. If the middleman is allowed to recover the entire overcharge from the violator, he will receive a windfall which he will be able to pocket, because no theory of law permits the end purchasers to sue him. The middleman is innocent and the mere fact that he has recovered damages from a violator does not give end

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[5] The municipalities are entitled to demand faithful compliance with those state statutes. They do have the right to enforce the statutes and to seek judicial review of the rates the Counties set, which must be reasonable and must be based upon cost recovery. If the Counties obtain any recovery in this case, it will go into the sewer funds they administer for the purposes authorized by law — provision of sewer treatment services. *See* Mich. Comp. Laws §§46.171 *et seq*; Mich. Comp. Laws §§123.731 *et seq*.

purchasers a cause of action against him, at least not under the federal antitrust laws.

That is the problem that may warrant an exception to the rule in *Hanover Shoe*, if the difficulties of economic tracing can be overcome. That problem does not exist here, for the reasons so ably stated by Petitioners. Here, because of the unique statutory relationships among the Counties and their constituent communities and, in turn, between the communities and the end users, any recovery by the Counties must and will accrue to the benefit of the end purchasers. That is to say, if damages are awarded to the Counties, Michigan law requires that they be treated as sewage fund assets. At that point, they either can be refunded to the constituent communities or applied to defray sewage expenses being incurred by the Counties, with consequent reductions of the bills to the communities and, in turn, to the end users. The economic benefit of the recovery is thus apportioned to those who were injured by the illegal acts.

By virtue of state law, the "perfect pass on" truly has been created. Illegal overcharges have indeed been passed on by the Counties and, as a matter of law, it is inevitable that an award redressing the illegal overcharges also will be passed on by the Counties to the communities which suffered the wrongful burden. Thus, every element of justice considered by this Court in *Hanover Shoe* and *Illinois Brick* is satisfied. No duplicate recovery can occur because the Counties' recovery, if any, will inure to the benefit of those who have borne the ultimate costs. Nor will a violator escape liability. Efficient administration of justice will occur because this "perfect" pass on is a statutory two-way street.

Denying standing to the Counties in this case would frustrate the effective enforcement of the antitrust laws and would defeat the settled jurisprudential policies addressed in *Hanover Shoe* and *Illinois Brick*. Extended to its logical conclusion, Petitioners' pass-on defense would require that only the end-user residents would have standing to sue. The economic complexities of apportioning the illegal overcharges

at that level, and the relatively small stake in the litigation that each resident may have, would surely frustrate the effective enforcement of the antitrust laws and would allow Petitioners to retain some portion of the "ill-gotten overcharges." *Illinois Brick*, *supra*, 431 U.S. at 752 (Brennan, J., dissenting). In this case, the Sixth Circuit correctly held that, because all of the policies underlying the antitrust laws — including the deterrence and compensation policies — will be well served, the circumstances do not warrant creating an exception to the rule in *Hanover Shoe*.

CONCLUSION

For all of the above reasons, the Petitions of Allevato, Detroit and Young should be denied.

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